

87-SBE-002

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
FIBREBOARD CORPORATION) **No. 84A-625-DB**

For Appellant: John C. Hart
Vice President-Finance

For Respondent: Anna Jovanovich
Counsel

O P I N I O N

25666^{1/} This appeal is made pursuant to section of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Fibreboard Corporation against a proposed assessment of additional franchise tax in the amount of **\$58,541.45** for the income year 1976.

1/ Unless otherwise specified, all section references **are** to sections of the Revenue and Taxation Code as in effect for the income year in issue.

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The question presented is whether the gain appellant realized from the sale of its 100-percent stock interest in Fibreboard Corporation Pty. Ltd. should be classified as business income apportionable by formula or nonbusiness income specifically allocable in its entirety to California, where appellant's commercial domicile is located.

Appellant's principal line of business is manufacturing products from wood, such as plywood, corrugated boxes, and folding cartons. One of appellant's affiliates was an Australian company named Pabco Products Pty. Ltd. (hereinafter referred to as Pabco), a manufacturer of building products, including roofing, flooring, and paint. From Pabco's creation in 1931 until 1973, all of its stock was owned by appellant or by appellant's predecessor, The Paraffine Cos., Inc. In 1973, appellant incorporated Fibreboard Corporation Pty. Ltd. (hereinafter referred to as FCPL) as a wholly owned subsidiary holding company whose sole asset was appellant's 100-percent stock interest in Pabco. As a result of financial difficulties encountered in 1975 and 1976, appellant sold some of its assets in order to reduce its debt. One of the assets sold was appellant's stock in FCPL. This sale resulted in a gain to appellant of **\$2,112,625**, a gain which respondent has determined to be nonbusiness income specifically allocable to California. Appellant contends, however, that the gain should be treated as business income apportionable by formula among all of the states in which appellant conducted its unitary business.

The issue on appeal is governed by the Uniform Division of Income for Tax Purposes Act (**UDITPA**) contained in sections **25120-25139**. Section 25120 defines "business income" and "nonbusiness income" as follows:

(a) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

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(d) "Nonbusiness income" means all income other than business income.

The statutory definition of business income provides two alternative tests for determining the character of income. The "transactional test" looks to whether the transaction or activity which gave rise to the income occurred in the regular course of the taxpayer's trade or business. The "functional test" provides that income is business income if the acquisition, management, and disposition of the property giving rise to the income were integral parts of the taxpayer's regular business operations, regardless of whether the income was derived from an occasional or extraordinary transaction. (Appeal of Fairchild Industries, Inc., Cal. St. Bd. of Equal., Aug. 1, 1980; Appeal of New York Football Giants, Inc., Cal. St. Bd. of Equal., Feb. 3, 1977; Appeal of Borden, Inc., Cal. St. Bd. of Equal., Feb. 3, 1977.)

Capital gains and losses are apportioned by formula. if they come within the definition of business income (Rev. & Tax. Code, § 25128) but are allocable to the state of the taxpayer's commercial **domicile** if they constitute items of nonbusiness income. (Rev. & Tax. Code; § 25125.) The labels customarily given items of income, such as dividends or capital gains, are of no aid in determining whether the income is business or nonbusiness income; the gain or loss on the sale of property, for example, may be business or nonbusiness income, depending on the relation to the taxpayer's trade or business. (Cal. Admin. Code, tit. 18, reg. 25120, subd. (c) (art. 2.5).) Generally, gain or loss from the sale of real or tangible or intangible personal property is business income if the property, while owned by the taxpayer, was used to produce business income. (Cal. Admin. Code, tit. 18, reg. 25120, subd. (c)(2) (art. 2.5).) Respondent's determination regarding the character of income as business or nonbusiness income is, of course, presumptively correct, and the taxpayer bears the burden of proving error in that determination. (See Appeal of Johns-Manville Sales Corporation, Cal. St. Bd. of Equal., Aug. 17, 1983.)

Appellant contends that the gain constitutes business income under the "functional" test, while respondent argues that it is nonbusiness income because the FCPL stock was simply an investment that was never an integral part of appellant's regular trade or business

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operations. According to appellant, its own operations and those of Pabco (the operating company whose relationship with appellant is the one really at issue here) were horizontally integrated, because the two companies shared common products and customers, common trademarks and trade names, some common directors, some technical information and know-how, and because appellant had originally endowed Pabco with all of its operating capital and with the patents and technical knowledge required to start its business. The difficulty with appellant's position is that it has produced little evidence in support of its allegations, and what evidence has been proffered relates entirely to earlier years going back to 1931 and not at all to the year in issue. There is, in short, no proof that the FCPL stock, or the assets it represented, were integrally related to appellant's unitary business operations at the time appellant decided to sell that stock. (Appeal of Occidental Petroleum Corporation, Opn. on Pet. for Rehg., Cal. St. Bd. of Equal., June 27, 1983; Appeal of Johns-Manville Sales Corporation, supra.) We must conclude, therefore, that appellant has failed to establish any error in respondent's **determination**.

It should be noted that further support for respondent's determination lies in appellant's failure ever to include Pabco in the franchise tax returns filed on behalf of appellant's unitary business. While it is certainly possible for a minority stockholding to be sufficiently related to the owner's unitary business to give rise to business income (see Appeal of Standard Oil Company of California, Cal. St. Bd. of Equal., Mar. 2, 1983), it will be considerably more difficult for a wholly owned subsidiary to be integrally related to its parent's unitary business without also being part of that unitary business for purposes of filing a combined report.

For the above reasons, respondent's action in this matter will be sustained.

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O R D E R

Pursuant to the views expressed in the opinion of the board *on file* in this proceeding, and good cause appearing therefor,

IT IS **HEREBY** ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Fibreboard Corporation against a proposed assessment of additional franchise tax in the amount of **\$58,541.45** for the income year 1976, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day Of January , 1987 by the State Board of Equalization, with Board Members Mr. Collis, Mr. Dronenburg, Mr. Bennett, Mr. Carpenter and Ms. Baker present.

Conway Ii. Collis , Chairman

Ernest J. Dronenburg, Jr. , Member

William M. Bennett , Member

Paul Carpenter , Member

Anne Baker* , Member

*For Gray Davis, per Government Code section 7.9